In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 1133

I. L. VAN ZANDT and RUTH B. VAN ZANDT,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

On April 29, 1957, Dr. Van Zandt and his wife (petitioners) created two separate trusts, one for the benefit of each of their two minor children. For a period of slightly over ten years, the income from the trusts was to redound to the benefit of the Van Zandt's children (either by accumulation for their benefit or by distribution to them); at the end of ten years and two months, the principal would revert to petitioners (R. 54-58, Pet. 40-42).

Shortly after creating the trusts, the Van Zandts deeded to Dr. Van Zandt as trustee (1) the real estate occupied by Dr. Van Zandt as an office (he is a physician specializing in surgery) and (2) the X-ray and other equipment used in his practice. Simultaneously, Dr. Van Zandt as trustee leased the real estate and equipment back to himself for the full ten year period (R. 63-64, Pet. 41). In 1958 and 1959, Dr. Van Zandt paid himself as trustee certain amounts as "rent" and claimed deductions for these amounts as "ordinary and necessary" business expenses of his medical practice. The Commissioner disallowed these deductions and instead allowed petitioners a deduction for the annual depreciation on the real estate and equipment. The Tax Court upheld the Commissioner's determination and the Court of Appeals for the Fifth Circuit affirmed (R. 8-12, 64-67, Pet. 42-48).

1. Petitioners admittedly divested themselves of the minimum powers necessary to take the trusts' income, if any, out of their return and make the trusts taxable as separate entities. (Sections 671-678 of the Int. Rev. Code of 1954.) However, those sections of the Code governing taxation of trusts do not establish that petitioners are entitled to a deduction. Section 162 permits the deduction of "ordinary and necessary" business expenses, including "rentals or other payments required to be make as a condition to the continued use or possession * * * of property * * * in which he [taxpayer] has no equity."

As both courts below held, the payments to the trusts were not "ordinary and necessary" business expenditures, because the transaction was lack-

ing in economic substance and was entered into for no other reason than to shift income to the trusts.[1] After the transfer, Dr. Van Zandt continued to use the property in his medical practice just as he had before. He retained full possession of the property both during the 10-year period of the trust and thereafter. As a part of a single series of interdependent steps, the Van Zandts transferred to Dr. Van Zandt as trustee the right to possession of the property for approximately ten years and he immediately reconveyed to himself individually a precisely coextensive right to possession in return for periodic cash payments. Eliminating this simultaneous transfer and retransfer of the possessory right to the property for ten years, Dr. Van Zandt in substance voluntarily bound himself to pay the trusts a certain amount each year (nominally termed "rental payments") for which he received nothing in return. The payments constitute gifts and not "necessary" business expenses. A taxpayer who wishes to give away cash cannot by the subterfuge of donating property to himself as trustee for a limited period and immediately leasing it back to himself convert the gifts of cash into necessary business deductions. Accordingly, the Commissioner has ruled in similar cases that the so-called "rental payments" constitute gifts

[1] The court of appeals did not have occasion to consider the government's alternative argument that the "rental" payments should be disallowed because the Van Zandts, who were to have the trust property returned to them in ten years, had an "equity" in such property. See *Hall* v. *United States*, 208 F. Supp. 584 (N.D. N.Y.).

and not income to the trusts. Rev. Rul. 54-9, 1954-1 Cum. Bull. 20; Rev. Rul. 57-315, 1957-2 Cum. Bull. 624.

2. The result reached below is in accord with *W. H. Armston Co.* v. *Commissioner*, 188 F. 2d 531 (C.A. 5); *White* v. *Fitzpatrick*, 193 F. 2d 398 (C.A. 2), certiorari denied, 343 U.S. 923; *Kirschenmann* v. *Westover*, 225 F. 2d 69 (C.A. 9), certiorari denied, 350 U.S. 834; *Ingle Coal Corp.* v. *United States*, 127 F. Supp. 573 (Ct. Cl.), certiorari denied, 350 U.S. 842; *Hall* v. *United States*, 208 F. Supp. 584 (N.D. N.Y.); *Unger* v. *Campbell* (N.D. Texas), decided November 14, 1960 (7 A.F.T.R. 2d 547).

3. Despite petitoners' argument and the Commissioner's statement in Rev. Rul. 54-9 (1954-1 Cum. Bull. 20) to the contrary, the decision in this case does not conflict with *Skemp* v. *Commissioner*, 168 F. 2d 598 (C.A. 7) or *Brown* v. *Commissioner*, 180 F. 2d 926 (C.A. 3). In both of these cases, the taxpayers gave up far more control over the property than in the instant case and thus the transfers had meaningful economic consequences. The taxpayer in *Skemp* conveyed an office building (part of which he occupied) to an independent corporate trustee for twenty years with the remainder interest to his children. He thus irrevocably divested himself of both complete and permanent ownership of the property and control over it. Similarly, in *Brown*, the taxpayer conveyed to a third party (albeit his attorney) as trustee for a far longer period than here.

In contrast, petitioners gave up no substantial economic interests in or control over the property. Dr. Van Zandt was sole trustee; simultaneously with receiving a ten year interest in the property from himself and his wife, he leased all of it back to himself for the identical period; he and his wife at all times retained the remainder interest. Petitioners in substance retained full control and ownership of the properties.

For these reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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